NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1 212 373 3000

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86 10 5828 6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road
Central Hong Kong
+852 2536 9933

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44 20 7367 1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81 3 3597 8101

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1 202 223 7300

WILMINGTON
Brandywine Building
1000 N. West Street, Suite 1200
Wilmington, DC 19801
+1 302 655 4410

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SEC Approves Enhanced Disclosure About Risk, Compensation and Corporate Governance

The SEC at its open meeting yesterday approved in a 4-1 vote amendments to its disclosure requirements related to executive and director compensation, corporate governance and director and director nominee background. Commissioner Kathleen Casey dissented, largely because she believed that the expansion of the director and director nominee disclosures would merely create more boilerplate rather than helpful disclosure and also ventured into policy making, encroaching upon a board's decision-making powers.

These amendments were originally proposed in July 2009 (see our memorandum summarizing the proposal at http://www.paulweiss.com/resources/pubs/detail.aspx?publication=2439). We highlight below the key changes to the original proposal that were discussed at the open meeting. The new rules will be effective on February 28, 2010, and presumably cover any proxy statements mailed after such date.

Variations from July Proposals

Employee Compensation Practices and Policies

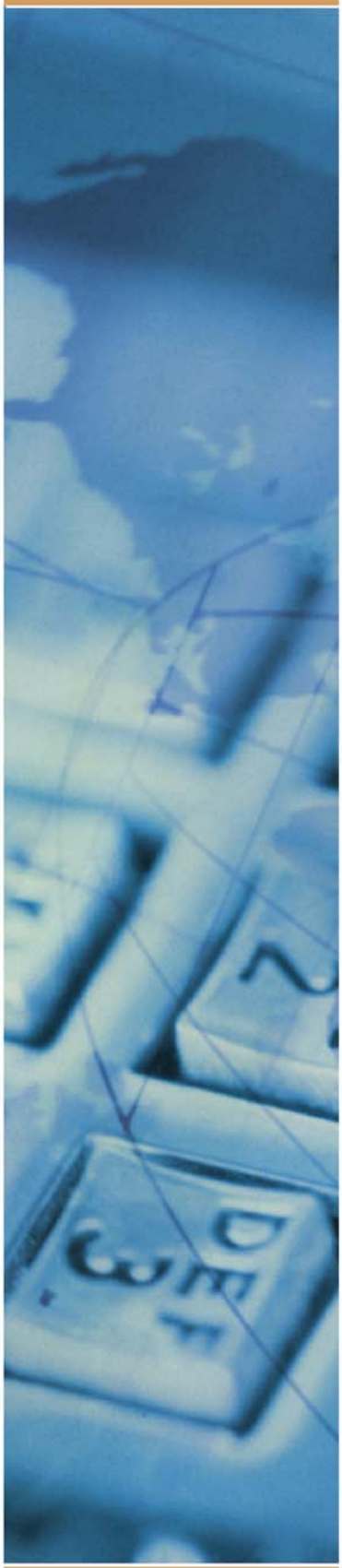
The SEC approved amendments to require companies to discuss the relationship of their risk oversight practices to their employee compensation polices and practices, if such policies and practices create risks that are reasonably likely to have a materially adverse effect on the company. This is a change from the original proposal, which would have required disclosure if compensation policies and practices "may have a material effect on the company."

In addition, the rules as adopted will not require the new disclosure to be included in the CD&A as originally proposed. The SEC agreed with comments received to the effect that it could be confusing to expand the CD&A to cover disclosure of compensation matters for individuals other than the named executive officers.

Tabular Disclosure of Stock and Option Awards

The SEC adopted amendments to the rules applicable to summary and director compensation table disclosure of compensation attributable to stock and option awards, to require that the tables show the aggregate grant-date fair value for these awards (as computed in compliance with Financial Accounting Standards Board Codification Topic 718). This revised disclosure would replace the currently mandated disclosure of the accounting expense (i.e., the dollar amount recognized for financial statement reporting purposes under FAS 123R) associated with stock and option awards for the applicable fiscal years.

In response to comments that the proposed rule could have discouraged companies from granting performance-based awards and potentially resulted in inflated reporting, the final amendments will include an instruction clarifying that, for awards subject to performance conditions, the amount to be included in the tables is the value on the grant date based on the probable outcome of the performance conditions (with footnote disclosure of the maximum



potential value of the award). Companies will be required to recalculate this disclosure for the current and past two fiscal years for its named executive officers, although they will not be required to change the list of named executive officers listed in the prior two fiscal years if that list would change as a result of the recalculation of the disclosed values of the stock and option awards.

Directors and Director Nominees

The SEC approved disclosure requirements related to the backgrounds of incumbent directors and director nominees as proposed, with two key changes. First, in addition to expanding the required period of disclosure for legal proceedings involving directors and director nominees from five to 10 years, the amendments also expand the definition of "legal proceedings" to include any judicial or administrative proceedings resulting from involvement in (i) mail and wire fraud or fraud in connection with any business entity, (ii) violations of federal or state banking or insurance laws and regulations and any settlements with respect to such actions and (iii) any disciplinary actions or sanctions imposed by stock, commodities or derivative exchanges or other self-regulatory bodies. Settlements of private civil litigation will not be required to be disclosed.

Second, the amendments also include a new requirement for companies to disclose whether, and if so, how, a nominating committee considers diversity in identifying director nominees. A nominating committee's policy on diversity, if any, would need to be disclosed, along with disclosure on how the policy is implemented and how the nominating committee or board assesses the effectiveness of such policy. The amendments do not define "diversity."

Risk Management

The amendments require additional disclosure as to the board's role in a company's "risk oversight" instead of "risk management" as originally proposed. This change was made in recognition of comments received noting that boards do not manage risk, but rather oversee risk.

Compensation Consultants

The SEC adopted rules calling for enhanced disclosure related to compensation consultants substantially as proposed, with certain modifications designed to require disclosure of compensation consultant fees only where potential conflicts of interest are most likely to exist. The final rule adds a *de minimis* exception such that disclosure of fees will not be required if the compensation consultant or its affiliates provide less than $120,000 worth of compensation or additional services to the company or its board in any fiscal year. The final rule also would not require fee disclosure if services relate to certain broad-based employee benefit plans or were general in nature and not customized for, or included advice based on, parameters set by the company.

Deferral of Proxy Solicitation Changes

The original proposal included certain revisions to the rules governing the proxy solicitation process. These proposals have been deferred so that they may be considered at the same time as the SEC's proxy access proposal, which will likely be taken up by the SEC early in 2010.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Any questions concerning the issues addressed in this memorandum may be directed to Mark S. Bergman (+44-207-367-1601), Raphael M. Russo (212-373-3309), Lawrence I. Witdorchic (212-373-3237) or Frances F. Mi (212- 373-3185).